Remarks by David N. Smith
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PERPETUATING PROSPERITY

Introduction

(Slide S-1: Perpetuating Prosperity)

I want to add my welcome to each of you here today. I know that some of you are new to our program, but several of you have faithfully attended this luncheon for the past four years.

As you may know we often use this forum to explain our differences. Those of us who work at TVA know we're different. In fact, we're proud of our differences: we just don't want to be penalized for them.

In years past, we've talked about our different mission.

(Slide S-2: Clothed with the Power…)

The TVA Act directs us to deliver power – not for profit, but at "the lowest feasible cost" – all the while promoting economic development and managing the Tennessee River for flood control, navigation and recreation.

And our capital structure is *different*, because we're told to finance our business exclusively from internally generated funds or from borrowings.

We have talked about our different, albeit substantial, tax burden.

(Slide S-3: Tax Equivalent Payments - Map)

At the State and Local level, we provide tax-equivalent support to the regions where we do business by distributing 5% of our revenues from sales to distributors and directly-served customers over $300 million last year.. .

(Slide S-4: Ultimate Federal Revenues)

At the Federal level, we have argued that since the interest paid on TVA's debt is subject to federal income taxes, there is a substantial *indirect* economic value that flows to the government. Indeed, the *combined* receipts associated with TVA are as great as those from other industry participants.

In spite of our differences, we think we're better!

(Slide S-5: Competitive Prices)

One recurring theme of our presentations has been a discussion of our competitive position. The average residential price in our region –four and a half pennies for TVA and two pennies for our distributors – puts us 23 percent lower than the national average and 21 percent lower than our largest competitors.

Furthermore we've taken steps to ensure this competitive advantage in the future.

(Slide S-6: Ten-Year Business Plan Objectives)

Most of you know that TVA adopted a 10-year Business Plan committing ourselves to several strategies to ensure a competitive cost of power in 2007.

Back then, our best guess was that the future market price for wholesale delivered power would drop to about 3.5 cents.

Since 1997, several new strategies have been adopted; other strategies have been modified. And the external environment has changed.

In fact, the most critical assumption of all – the three and half cent market price of power – may turn out to have been too low. If this is true, that may lessen the pressure, but we have not relaxed our determination to drive down our cost.

I said it last year, and I'll say it again. In my judgment, we are "on target" for offering power at a competitive price in 2007.

Fiscal 2000 Projections

(Slide S-7: Fiscal 2000 Projections)

While we're talking about the future, let me briefly review our current year projections.

(Slide S-8: Fiscal 2000 Income Projection)

Our budget called for net income to be a little ahead of 1999, but that's going to be a challenge, the way we've started off. The winter in the Tennessee Valley was warm and dry. It's been a perfect place to live, but a terrible place to run a power company.

(Slide S-9: Fiscal 2000 Cash Flow Projection)

If we get lucky and get back on plan with a hot summer, we'll generate enough cash flow to again reduce our debt by $300 million. That will amount to a $1.6 billion reduction from our peak.

Let's talk longer term.

You can all appreciate how sound operations and a capable workforce insure future competitiveness. Let me suggest another factor determining TVA's competitiveness will be our financial flexibility.

Financial Flexibility

(Slide S-10: Financial Flexibility)

The boundaries of financial flexibility are challenged today because financial environments are changing more swiftly than ever. Two percent daily swings in equity markets are commonplace swings of five percent are not unheard of. Yield curves are inverted. Agency spreads widened ten percent on Wednesday.

To manage in this challenging environment, we have committed ourselves to *improve* our financial flexibility – and I believe we have a record to show for it.

Before discussing financial flexibility, I'll offer my definition of the term.

(Slide S-11: Financial Flexibility - Definition)

In my judgment, the notion of financial flexibility reflects an enterprise's ability to swiftly, sufficiently and economically respond to the financial demands of business. The enterprise must be able to do this from internal cash generation or with money raised from external financial markets.

I propose discussing several measures of our financial flexibility this afternoon. Hopefully, at least one approach will match your understanding of the term.

Look first at TVA's financial flexibility as it measures our ability to fund our business with internally generated cash.

(Slide S-12: Cash Flows From Operations - Pre-Interest)

In particular, look at our cash flow from operations, before capital spending, and before servicing our capital structure. Five years ago, the number was $2.7 billion: last year, the number was $3.2 billion.

(Slide S-13: Cash Flows From Operations - After-Interest)

After servicing interest on our debt, the record is even more impressive showing steady growth from $802 million to $1.4 billion over the five years – an improvement of more than 75%.

But, maybe your definition of financial flexibility refers to *sufficiency*. In other words, can a firm raise *sufficient* capital to finance its needs?

(Slide S-14: Borrowing Capacity)

As you know, TVA's borrowing authority is not a function of any line of credit, as it might be for a private company – rather, it is a function of our $30 billion congressional borrowing authority.

When we committed ourselves to debt reduction in 1997, our unused borrowing authority was $2.6 billion. That's a lot of money in an absolute sense, but it only permitted an 8.7% increase in our then outstanding debt. By the end of last year, the margin had increased to over 12%.

Unused borrowing authority provides both insurance and financial flexibility. We believe it is prudent financial management to increase the margin as our business environment becomes increasingly volatile.

(Slide S-15: Interest Coverage)

Maybe you judge financial flexibility in terms of fixed cost coverage, or more narrowly, interest coverage. If so, I would point out that with our cash flow improvements and our debt reduction, interest coverage has dramatically improved. If the coverage ratio seems small, remember that interest expense represents virtually our *entire* cost of capital.

In fact, humor me for a moment as I digress into a continuing debate I have had with analysts who insist on classifying dividends, income and taxes as "variable" costs when they review investor owned utilities.

In my judgment, these are *not like* operating expenses that can be curtailed or eliminated in hard times – not if the enterprise expects continued access to capital markets for future growth.

The investments of common and preferred shareholders must be serviced with the same diligence as traditional debt obligations. My passion for arguing this point is driven by TVA's unique capital structure, comprised, as it is, almost entirely of unsecured debt.

Having said that, though, I would encourage you again to look at the progress we have made in improving our interest coverage.

The net cash provided by operations before interest was 1.4 times total interest expense in 1995. By last year, the ratio had increased to 1.8 times. – a 28% improvement. I *challenge* you to perform the same analysis for our competitors, basing the ratio on their *total* cost of servicing their total capital structure – interest, preferred dividends, common dividends and profits, net of tax.

A few of you may think of financial flexibility as the interest burden on revenue.

(Slide S-16: Interest % of Revenue)

In TVA's case, interest had reached the burdensome height of more than one-third of revenue in 1997. Last year, it was down almost seven percentage points! It is our hope that we can reduce it to 25% of revenue in the near future.

Finally, let me encourage you to consider TVA's financial flexibility in yet another, more informative, way – related to the productive assets that support our capital structure.

(Slide S-17: Debt to Generating Capacity)

In 1995, we had close to 26 thousand megawatts of generating capacity and $27 billion of debt. The simple ratio of these two equaled $1,049 per kilowatt. Five years later, the ratio was down to $925 per kilowatt.

If your initial impression is that this debt is high compared to auction prices for generating assets you have seen in past few years, remember that this calculation assigns our entire debt burden – virtually our entire capital structure – to the generating assets alone.

In other words, it attributes *no value* for 17,000 miles of transmission lines, *no value* for our long-term customer contracts, *no goodwill* for the integrated TVA franchise. In fact, the collection of generating assets themselves have no value recognition for their superior operating performance.

Conclusion

(Slide S-18: Perpetuating Prosperity)

So, what is the appropriate measure of financial flexibility? We believe there are several, but by any appropriate measure, TVA can demonstrate the financial flexibility to perpetuate prosperity and support our competitiveness in the future.

Our internal cash flow is improving and, at the same time, available credit externally is expanding. The fixed cost of servicing our capital structure is becoming less, fixed cost coverage is improving and the interest burden on revenue is becoming less. Most importantly, in my view, TVA is reducing its capital investment per unit of production.

I haven't said much about our debt financing program, so let me at least acknowledge that that's the reason we are together today. We continue to have a need for financing, even while we try to reduce our debt. We depend on each of *you* for new, innovative financing ideas. We certainly welcome your continued input.

It is our hope that you will better understand the uniqueness of the mission we serve and appreciate the distinction with which we serve.

We look forward to continuing our relationship in 2000.

Now I'll turn the program over to Chairman Crowell.